IN THE SUPREME COURT OF THE UNITED STATES

MICHAEL H. BOULWARE,

Petitioner,

-v.-

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED FOR REVIEW

1. Whether The Diversion of Corporate Funds to a Shareholder of the Corporation, Without Earnings and Profits, Automatically Qualifies As a Non-Taxable Return of Capital Up to the Shareholder's Stock Basis Even If the Diversion Was Not intended As A Return of Capital.

TABLE OF CONTENTS

Page

Questions Presented for Review ii

Table of Authorities iv

Interest of *Amicus Curiae* 1

Summary of Argument 2

Argument:

Point I -- The Due Process Clause Of The Fifth Amendment To The Constitution Coupled With the Plain Language Of The Internal Revenue Code Supports the Application Of The Return Of Capital Or "No Income No Earnings Rule" Of Sections 301(C)(2) and 316(A)(1) Of The Internal Revenue Code To Criminal Prosecutions Brought Pursuant To Title 26 U.S.C. §7201 4

Conclusion 11

TABLE OF AUTHORITIES

Page

CASES:

Davis v. United States, 226 F.2d 332 (6th Cir. 1955) 3, 4, 8, 9

DiZenzo v. Commissioner, 348 F.2d 122 (2d Cir. 1965) 3, 7

In re Winship, 397 U.S. 358, 90 S. Ct 1068 (1970) ..... 2, *passim*

Lawn v. United States, 355 U.S. 339, 78 S. Ct. 311 (1958) 6

Leland v. Oregon, 343 U.S. 790, 72 S. Ct. 1002 (1952) 5

Sansone v. United States, 380 U.S. 343, 85 S. Ct. 1004 (1965) 6, 7

Spies v. United States, 317 U.S. 492, 63 S. Ct. 364 (1943) 6

Truesdell v. Commissioner, 88 T.C. 1280 (1987) ... 7

United States v. Bok, 156 F.3d 157 (2d Cir. 1998) 3, 7, 9, 10, 11

United States v. Booker, 543 U.S. 220 (2005)..... 5

United States v. Boulware, ___ F.3d ___, slip op at 19415 (9th Cir. 2007) ..... 3, *passim*

United States v. D'Agostino, 145 F.3d 69 (2d Cir. 1998) ..... 3, *passim*

United States v. Leonard, 524 F.2d 1076 (2d Cir. 1975) 8

United States v. Miller, 545 F.2d 1204 (9th Cir. 1976) ..... 3, *passim*

United States v. Williams, 875 F.2d 846 (11th Cir. 1989) 7, 8

OTHER AUTHORITIES:

Title 26, United States Code

Section 301 ..... 3, *passim*

Section 316 ..... 3, 4, 6

Section 7201 ..... 3, *passim*

This *Amicus Curiae* Brief is submitted in support of the position of the Petitioner, Michael H. Boulware. Written consents of the parties to the filing of this Brief have been contemporaneously submitted to the Clerk of the Court.[1]

INTEREST OF *AMICUS CURIAE*

The National Association of Criminal Defense Lawyers (NACDL) is a non-profit corporation whose membership is comprised of almost 10,000 lawyers and 28,000 affiliate members representing every state, including private criminal defense attorneys, public defenders, and law professors. Members serve in positions bringing them into daily contact with the criminal justice system in the state and federal courts.

NACDL was founded in 1958 to promote criminal law research, to advance and disseminate knowledge in the area of criminal practice, and to encourage integrity, independence, and expertise among criminal defense counsel. NACDL is particularly dedicated to advancing the proper, efficient, and fair administration of justice, with a focus on the role and duties of lawyers representing parties in administrative, regulatory, and criminal

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[1] As required by Rule 37.6 of this Court, *Amicus Curiae* submit the following statement: No party authorized this Brief while or in part; and no person or entity, other than *Amicus Curiae*; its members or its counsel has made a monetary contribution to the preparation or submission of this Brief.

investigations. In furtherance of this and its other objectives, NACDL files approximately 35 *amicus curiae* briefs each year, in this Court and others, addressing a wide variety of criminal justices issues.

The NACDL is the only national bar organization working on behalf of public and private defense lawyers. The American Bar Association recognizes the NACDL as an affiliated organization and awards it full representation in the ABA House of Delegates. The NACDL is dedicated to the preservation and improvement of our adversary system of justice.

The NACDL submits this Brief because it shares this Court's conviction that the due process clause of the Fifth Amendment protects the accused against conviction, except upon proof beyond a reasonable doubt of each and every element of the crime charged, including tax offenses. *In re Winship*, 397 U.S. 358, 90 S. Ct 1068, 1073 (1970), and that standard plays a "vital role" in our criminal procedure. *Id.*. at 1072. The NACDL is committed to preserving that "vital role" in this country.

SUMMARY OF THE ARGUMENT

It is NACDL's position that in the context of a criminal prosecution for tax evasion, the diversion of corporate funds to a shareholder of a corporation without earnings and profits automatically qualifies as a non-taxable return of capital up to the shareholders stock basis even if the diversion was originally not labeled as a return of capital. In that

connection, NACDL urges the Court to adopt the rationale of the United States Court of Appeals for the Second Circuit in *United States v. Bok,* 156 F.3d 157 (2d Cir. 1998); *United States v. D'Agostino*, 145 F.3d 69, 72 (2d Cir. 1008); and *DiZenzo v. Commissioner,* 348 F.2d 122, 125 (2d Cir. 1965). Those cases hold that money lawfully withdrawn from a corporation by one of its shareholders may constitute a non-taxable return of capital in both civil and criminal prosecutions for tax evasion provided that the corporation must not have earned a profit for the year in which the withdrawal was made.

Conversely, NACDL asks the Court to reject the holdings and rationale of *United States v. Miller*, 545 F.2d 1204 (9th Cir. 1976) and its forbearers that the return of capital analysis does not apply in criminal cases. *United States v. Miller*, at 1213, citing and relying on *Davis v. United States*, 226 F.2d 332 (6th Cir. 1955).

NACDL bases its position on several factors: first, allowing a criminal conviction under 26 U.S.C. § 7201, without proof beyond a reasonable doubt of a tax deficiency, as *Boulware* and *Miller* suggest, violates the constitutional due process requirement that a conviction requires proof beyond a reasonable doubt of all essential elements of a criminal offense. *In re Winship*, 397 U.S. 358, 364, 90 S. Ct. 1068 (1970).

Second, a plain reading of the statutory provisions, Sections 301 and 316 of Title 26 United States Code, demonstrates that when a corporation

has no earnings or profits in a given year, distributions to a shareholder "out of its earnings and profits," 26 U.S.C. § 316(a)(1), constitutes a non- taxable return of capital.

Third, the Ninth Circuit in *Boulware* relied upon a line of cases spawned by *Davis v. United States*, 226 F.2d 331 (6th Cri.1955), which was decided long before *Winship*, and which, upon analysis, compels the conclusion that *Davis* was wrongly decided. Thus, the house of cards upon which *Boulware* is constructed, including *United States v. Miller*, 545 F.2d 1204 (9th Cir. 1976), collapses.

ARGUMENT

1.THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE CONSTITUTION COUPLED WITH THE PLAIN LANGUAGE OF THE INTERNAL REVENUE CODE SUPPORTS THE APPLICATION OF THE RETURN OF CAPITAL OR "NO INCOME NO EARNINGS RULE" OF SECTIONS 301(C)(2) AND 316(A)(1) OF THE INTERNAL REVENUE CODE TO CRIMINAL PROSECUTIONS BROUGHT PURSUANT TO TITLE 26, U.S.C. §7201.

The due process clause of the Fifth Amendment states that no person may "be deprived of life liberty or property, without due process of law. . . ." *In re Winship*, 397 U.S. 358, 90 S. Ct. 1068. *In Winship*, this Court unequivocally and explicitly held that the reasonable doubt standard of the due process clause protects an accused against

conviction; except "upon proof beyond a reasonable doubt of every fact necessary to constitute the crime with which he is charged." 90 S. Ct. at 1073. The Court based its holding on several sound principles, which are applicable in this case. These include the tenet that the reasonable doubt standard plays a vital role in the "American scheme of criminal procedure" by reducing the risk of conviction based on factual error" when a liberty interest is a stake. *Id.* at 1072.

The Court also agreed with the dissenters in the New York Court of Appeals (in the decision below in *Winship*) that "a person accused of a crime * * * would be at severe disadvantage, a disadvantage amounting to a lack of fundamental fairness, if he could be adjudged guilty and imprisoned for years on the strength of the same evidence as would suffice in a civil case. *Id.* at 1092, citing 24 N.Y.2d 196 at 205 (1969). *See e.g., United States v. Booker*, 543 U.S. 220, 230 (2005).

As Mr. Justice Frankfurter observed in *Leland v. Oregon*, 343 U.S. 790, 795, 72 S. Ct. 1002, 1005-06 (1952) "[i]t is the duty of the Government to establish * * * guilt beyond a reasonable doubt. This notion – basic in our law and rightly one of the boasts of a free society – is a requirement and safeguard of due process of law in the historic, procedural context of due process." *Id.* (72 S. Ct. at 1009 – dissenting opinion). There can be no doubt that the holding of *Winship* applies to criminal prosecutions under the I.R.C.

In *Sansone v. United States*, 380 U.S. 343, 85 S. Ct. 1004 (1965), the petitioner was convicted *inter alia,* for willfully attempting to evade his federal income taxes in violation of Section 7201 of the Internal Revenue Code of 1954 -- the same statute of which petitioner herein stands convicted. This Court, relying on *Lawn v. United States*, 355 U.S. 339, 361, 78 S. Ct. 311, 323 and *Spies v. United States*, 317 U.S. 492, 496-97, 63 S. Ct. 364, 366-67 (1958) held that the elements of Section 7201 are willfulness; *the existence of a tax deficiency,* and an affirmative act constituting an evasion or attempted evasion of tax.[2] Bad or evil intentions alone are not punishable as a crime. *United States v. D'Agostino*, 145 F.3d 69, 73 (2d Cir. 1998). Section 7201 makes clear that there must be a tax deficiency before a conviction can occur in corporate diversion cases.

Two interrelated provisions – I.R.C. Sections 301 and 316 – govern the taxation of money taken by a taxpayer from a corporation in which he owns stock. Section 301 provides in pertinent part: " ... a distribution of property . . . made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c). In turn, subsection (c)(2) provides that in a case of a distribution "a portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock." Completing the syllogism, Section 316(a) provides that "'dividend'

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[2] Title 26, United States Code, Section 7201 states:

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony.

means any distribution of property made by a corporation to its shareholders . . . *out of its earnings and profits* . . . ."

These statutes, when read together, clearly and precisely define the return of capital or no earnings and profits no income rule now firmly established, *DiZenzo v. Commissioner*, 348 F.2d 122, 125 (2d Cir. 1965), adopted by the Internal Revenue after the tax court's decision in *Truesdell v. Commissioner*, 88 T.C. 1280 (1987), and applied to criminal cases in *United States v. D'Agostino*, and *United States v. Bok*, 156 F.3d 157 (2d Cir. 1998).

In *Bok*, the Second Circuit recognized that monies lawfully withdrawn from a corporation by one of its shareholders may constitute a non-taxable return of capital. The court reasoned that if a shareholder has invested capital in a corporation and the corporation has not earned a profit for the year at issue, any monies the shareholder removed from the corporation up to his invested capital constitutes only a return of the shareholder's basis and *not* dividend income.

The holding of *United States v. Miller*, 545 F.2d 1 204 (9th Cir. 1976) and its progeny, including *United States v. Williams*, 875 F.2d 846 (11th Cir. 1989), which refused to apply the return of capital rule to criminal cases should be rejected by this Court for a number of reasons. First, *Miller* omits the element of a tax deficiency, and therefore runs afoul of *Sansone*, and the constitutional requirements of *Winship*. Second, *Boulware*, *Miller* and *Williams* hold that despite a taxpayer's

wrongful intent with respect to diverted income, as a sole shareholder of a corporation, he cannot be held *liable civilly* for a distribution that exceeds the corporation's earnings and profits and which does not exceed the shareholder's adjusted basis.

Under *Miller* and its progeny, those distributions in civil cases are considered "return of capital." *See Miller*, at 1210-12, n. 5. *Miller* and *Boulware* thus hold that a defendant may be convicted of criminal tax evasion without owing a penny in taxes. As Judge Thomas stated in his concurring opinion in *Boulware* "not only does this result indicate a logical fallacy, but is in fact a contradiction with the tax evasion requirement of the existence of a tax deficiency." *United States v. Boulware*, ___ F.3d ___, slip op at 19415 (9th Cir. 2007). *See also United States v. Leonard*, 524 F.2d 1076 (2d Cir. 1975 (Friendly, J.). In addition, the approach taken in *Miller, Williams,* and *Davis*, upon which both cases rely, effectively eliminate proof of a tax deficiency as an element of 26 U.S.C. Section 7201.

Under *Miller, Williams,* and *Davis,* the government would need prove only that the taxpayer willfully intended to exercise domain and control over the diverted funds and, through effective acts, to evade paying taxes. If Congress intended this showing to suffice, it would not have included a tax deficiency as a requisite element. This Court should also decline to adopt the *Miller-Williams* rule because those cases relied on *United States v. Davis*, 226 F.2d 331, 335-36 (6th Cir. 1955).

Davis was wrongly decided because it was based upon the assumption that any exercise of domain and control by a taxpayer over diverted funds from a corporation is an unlawful act that must be treated as ordinary income. The court in *Davis* simply refused to apply the return of capital rule in criminal tax cases. Davis' conviction was upheld simply based on his evil intent.

Similarly, the holding in *Miller* should not stand in this Court because it misconstrues the role of intent in defining a taxpayer's conduct. In return of capital cases, a taxpayer's intent is not exclusively determinative in defining the taxpayer's conduct. Under 301(c) of the I.R.C., the taxpayer or the corporation need not have contemporaneously described the distribution at issue as a dividend or return of capital at the time it was made.

Rather, as the Second Circuit in both *Bok* and *D'Agostino* recognized, "the reality of the transaction, including the amount of the shareholder's basis and the corporation's earnings or profits, as well as the amount of the distribution govern its characterization for tax purposes." *D'Agostino*, 145 F.3d at 72, 73; *Bok*, 156 F.3d at 162. Thus, in *Bok* and *D'Agostino*, the Court(s) applied a return of capital theory even though in both cases the Court(s) had little doubt that defendants therein had acted with bad intent.

Though it may be true that a defendant may have the burden of going forward to establish no corporate earnings or profits, once that proof is presented, the prosecution shoulders the burden of

proving a deficiency beyond a reasonable doubt. *See United States v. Bok,* 156 F.3d at 163.

Accordingly, the return of capital defense in criminal tax violations more closely follows the overall scheme of the I.R.C., while the subjective intent-driven rule of *Miller* and its progeny clearly frustrates the uniform application of the tax laws, and deprives criminal defendants of their right to have each and every element of the offense proved beyond a reasonable doubt.

CONCLUSION

This Court should adopt the return of capital rule in criminal cases as announced in *United States v. Bok* and *United States v. D'Agostino* and reject the holding of the Ninth Circuit in *United States v. Boulware* and its forbearers.

Dated: New York, New York
November 9, 2007

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